15. A carrier should share with other carriers some portion of the revenues it receives as a result of roaming by customers of the other carriers through negotiated roaming arrangements, taking into account individual carrier's costs and expected benefit to the carrier in whose territory the end user roams.

16. A carrier who chooses to offer enhanced services should be required to offer to provide them to its wholesale customers nondiscriminatory and on a nontariffed basis.

17. End user rights to tariffed services should be protected from nontariffed services.

18. Advantage Group's comments should be considered only to the extent that its comments corroborate other parties' comments.

19. Controls to encourage duopoly competition within a discretionary market should be implemented through regulatory oversight to enhance competition among the carriers and to protect the basic rights of end users.

20. The record does not substantiate that cellular carriers are earning an excessive return on their investment. A monitoring program to track the utilization of the spectrum by facilities-based cellular carriers should be established.

21. The combination of regulatory protections and competition-enhancing policies adopted in this decision will assure that cellular wholesale and retail rates are just and reasonable.

22. A streamlined certification process for RSA carriers should be authorized.

23. The rate proposals of DRA and CRA should not be adopted.

24. Cellular carriers' interconnect agreement with LECs should not be tariffed and should be based on a nondiscriminatory basis, standard terms and conditions which include options for various serving arrangements and pricing structures, and should negotiate cellular interconnection agreements based on these standard terms and conditions.

25. The LECs should be required to support their cost to provide interconnection service to the cellular carrier.

26. All future interconnection agreements should include a mandatory nondiscriminatory clause.

27. Cellular carriers should be classified as LECs co-carriers.

28. Cellular carriers should be required to pay for the use of the LEC facilities they order pursuant to nondiscriminatory interconnection agreements with LECs but should not be required to pay for NTS costs associated with the local loop.

29. SJREB's wholesale proposal should not be adopted.

30. Carriers should implement a large user tariff if there is demand for such service within their SMSAs. Such a large user tariff should contain retail rates which are at levels at least five percent above the wholesale rate but below retail rates. A "large user" should be uniformly defined in the cellular service providers' tariffs as either: (1) a bulk user that purchases cellular service for its own use, or (2) a large organization (such as an affinity group or professional association) that (a) purchases service in volume for the use of its members, officers or employees, and (b) passes through the cost of service to such members, officers or employees. Such a large user should not be considered to be engaging in cellular service resale.

31. CRA's motion to accept Attachment D in its Phase II comments should be granted.

32. The facilities-based carriers should be responsible for innovative pricing schemes for retail rates.

33. Retail cellular carriers should be classified as nondominant telecommunications carriers. This nondominant status should not be applicable to entities which sell cellular services at retail in markets where they either operate or have applied for a FCC facilities-based license.

34. The guidelines and D.89-07-019 adopted by carriers in C.86-12-023 should be adopted and applied to carriers as policy.

35. The issue of whether a facilities-based carriers affiliate should be prohibited from reselling in markets where the facilities-based carrier provides retail service should be considered in the next phase of this investigation.

36. Commission payments to agents should not be restricted.

37. Cellular carriers should include provisons in their large-user tariffs requiring parties buying service thereunder to undertake certain disclosures to individual users.

38. Cellular carriers should be authorized to file revised tariffs in accordance with the more flexible policies articulated in this opinion.

39. The notice period for tariff filings should be revised.

40. Revisions to the cellular USOA should be addressed in the next phase of this investigation.

INTERIM ORDER

IT IS ORDERED that:

1. Cellular service shall be classified as a discretionary service and shall not be considered a universal basic service until such time that the cost of cellular service approaches that of conventional wireline service and until it becomes a direct competitor to conventional landline service.

2. Cellular utilities are authorized to provide, at the wholesale level, nondiscriminatory enhanced services on a detariffed basis.

3. Cellular carriers shall not disconnect any cellular services solely for nonpayment of enhanced service charges and shall notify their customers receiving bills for enhanced services of this rule when the customer receives its first such bill.

4. Cellular carriers shall track all enhanced service complaints as to the number and nature of complaint. All complaints shall be made available to CACD upon request.

5. LECs shall not enter into a billing arrangement with cellular carriers to bill cellular rates to landline customers initiating a call to a cellular customer at this time.

6. A carrier should share with other carries some portion of the revenues it receives as a result of roaming by customers of the other carriers through negotiated roaming arrangements, taking into account individual carrier's costs and expected benefit to the carrier in whose territory the end user roams.

7. Cellular Resellers Association, Inc.'s motion to file Attachment D to its Phase II comments is granted.

8. Cellular utilities tariff requirements shall be modified as follows, pursuant to GO 96-A(XV):

a. The facilities-based carrier's 40-day tariff notice is reduced to 30 days.

b. A cellular carrier's or reseller's rate reduction tariff filing which will not impact a carrier's average customer's bill by more than 10 percent, whether it be a facilities-based carrier or a reseller, shall be classified as a temporary tariff and made effective on the date filed. The temporary tariff status shall also be applicable to advice letter filings not imparting any price changes.

(1) Absent any protest to the tariff filing within the statutory 20-day protest period, the temporary status of the tariff shall expire and it shall be classified as a permanent tariff pursuant to the terms of the tariff provisions.

(2) If a protest is filed, the tariff shall remain a temporary tariff until the protest has been resolved or by order of the Commission.

9. A cellular carrier seeking an increase in rates shall substantiate its request in an advice letter filing and shall provide:

a. Market studies based specifically on data within its respective MSA.

b. Actual return on investment data for its prior 3 calendar years.

c. Projected return on investment based on its proposed rates.

d. Explanation of any major change (50 basis points) in the projected return on investment over the prior 3-year recorded average.

e. Cost-support data as requested by Commission staff.

10. Interconnection arrangements between cellular carriers and LECs shall be offered on a nondiscriminatory basis and shall not be tariffed. LECs shall offer to cellular carriers, on a nondiscriminatory basis, standard terms and conditions which include options for various serving arrangements and pricing structures, and shall negotiate cellular interconnection agreements based on these standard terms and conditions.

11. The local exchange companies shall substantiate their cost to provide interconnection to a cellular carrier upon request of the cellular carrier.

12. LECs shall not provide "mutual compensation" to the cellular carriers at this time.

13. A cellular carrier shall pay access charges for the use of the LEC access facilities it orders pursuant to a nondiscriminatory interconnection agreement with the LEC, and shall not pay for NTS costs associated with the local loop.

14. A retail cellular carrier not associated with either a facilities-based cellular carrier or an entity applying for a facilities-based carrier permit before the FCC shall be classified

a nondominant carrier and shall obtain the same benefits as other nondominant telecommunications carriers.

15. There shall be no mandatory margin between the wholesale and retail rates of facilities-based carriers. However, individual facilities-based carriers shall not deviate from the current mandatory retail margin until cost-allocation methods are adopted and implemented as part of the cellular USOA unless they can demonstrate through an advice letter filing that the retail operation will continue to operate on a break-even or better basis with proposed rate changes that impact the mandatory retail margin.

16. Cellular carriers shall adopt the following guidelines regarding agent arrangements:

a. No provider of cellular telephone service may provide, cause to be provided, or permit any agent or dealer or other person or entity subject to its control to provide cellular telephone service at any rate other than such provider's tariffed rate. No such provider may permit any agent or dealer or other person or entity subject to its control to pay for all or any portion of the cellular service which it provides to any customer.

b. Unless authorization has been sought and obtained through an advice letter filing in accordance with the provisons of GO 96-A, no provider of cellular telephone service may provide, either directly or indirectly, any gift of any article or service of more than nominal value (e.g., permitted gifts could be pens, key chains, maps, calendars) to any customer or potential customer in connection with the provision of cellular telephone service.

c. Unless authorization has been sought and obtained through an advice letter filing in accordance with the provisons of GO 96-A, no provider of cellular telephone service may provide, cause to be provided, or permit any agent or dealer or other person or entity subject to its control to provide to any customer or potential customer any

> equipment price concession or any article or service other than nominal value which is paid for or financed in whole or in part by the service provider and which is offered on the condition that such customer or potential customer subscribes to the provider's cellular telephone service.

17. Commission rates that cellular carriers pay to its agents shall not be restricted.

18. Facilities-based carriers shall implement a "large-user" tariff for its customers if sufficient demand exists within a MSA. The large user tariff rate shall be set at least five percent (5%) higher than the carrier's retail rate. To qualify for the large-user tariff the entity must serve as the master customer, guarantee payment for all usage by its members, and not apply any additional charges to its members for such services. The five percent margin shall not affect any rate offered by a carrier to a government agency.

19. Cellular carriers who want to block cellular telephone instrument ESNs shall tariff their blocking procedures and requirements for releasing the ESN blocks consistent with the guidelines identified in this opinion.

20. C.86-12-023 is closed.

21. Within 90 days of the effective date of this decision, all certificated carriers shall file amended tariffs to reflect the policies regarding customer deposits identified in this opinion.

22. Cellular carriers shall implement consumer protection provisions in their respective large user tariffs for large users who do not use the service for their own personal use.

23. This investigation is kept open to address through either workshops, or evidentiary hearings:

a. A streamlined certification process for RSA facilities-based carriers.

b. The ability of cellular resellers to perform switching functions currently provided by the cellular carriers and the

unbundling of the wholesale tariff rate element.

c. Whether or not a facilities-based carrier's affiliate should be prohibited from reselling in markets where the facilities-based carrier provides retail services.

d. Duopoly carriers' reporting requirements that will enable us to assess and monitor on a twice-yearly basis cellular capacity utilization, capacity expansion, development of cellular services in rural areas, and prices charged for cellular services.

e. Modify the USOAs to include cost-allocation methods for a carriers's wholesale and retail operations.

This order is effective today.

Dated June 6, 1990, at San Francisco, California.

G. MITCHELL WILK
President
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

I will file a written dissent.

/s/ FREDERICK R. DUDA
Commissioner

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List of Appearances

Respondents: Orrick, Herrington & Sutcliffe, by Ronald Aronovsky and Robert Gloistein, Attorneys at Law, for Fresno MSA Limited Partnership; Jackson, Tufts, Cole & Black, by William Booth, Joseph S. Faber, and Evelyn K. Mc Cormish, Attorneys at Law, for U S West Cellular of California, Inc.; Mary B. Cranston and Roger P. Downes, Attorneys at Law, for PacTel Cellular, PacTel Mobile Service, L.A. SMSA Ltd. Partnership, and Sacramento Valley Ltd. Partnership; Graham & James, by Martin A. Mattes and Richard L. Goldberg, Attorneys at Law, for Bay Area Cellular Telephone Company; Rod Johnson and Cynthia D. Scott, Attorneys at Law, for GTE Mobilnet, Incorporated; Bonnie Packer, Attorney at Law, for Pacific Bell; Alan Pepper, Attorney at Law, for Cellular Dynamics Telephone Company of Los Angeles, Inc.; Cooper, White & Cooper, by Mark P. Schreiber, E. Garth Black, and Alvin H. Pelavin, Attorneys at Law, for Roseville Telephone Company; Dinkelspiel, Donovan & Reder, by David A. Simpson, Attorney at Law, for Santa Barbara Cellular Systems, Ltd., Santa Cruz Cellular Telephone Company, Bakersfield Cellular Telephone Company, and Cagal Cellular Communications Corporation; Armour, St. John, Wilcox, Goodin & Scholtz, by James D. Squeri and Barbara Snider, Attorneys at Law, for GTE Mobilnet; Morrison & Foerster, by James M. Tobin and Marc P. Fairman, Attorneys at Law, for McCaw Cellular Communications, Inc. and Affiliates; and Dinkelspiel, Donovan & Reder, by David M. Wilson, Attorney at Law, for Los Angeles Cellular Telephone Company.

Interested Parties: Cooper, White & Cooper, by Mark P. Schreiber, E. Garth Black, and Alvin H. Pelavin, Attorneys at Law, for Calaveras Telephone Company, California-Oregon Telephone Company, Ducor Telephone Company, Foresthill Telephone Company, The Volcano Telephone Company, and Ponderosa Telephone Company; C. Hayden Ames, Attorney at Law, for Chickering & Gregory; Davis, Young, Beck & Mendelson, by Jeffrey F. Beck and Sheila B. Brutoco, Attorneys at Law, for CP National, Citizens Utilities Company of California, Evans Telephone Company, Happy Valley Telephone Company, Hornitos Telephone Company, Kerman Telephone Company, Pinnacles Telephone Company, Sierra Telephone Company, Inc., The Siskiyou Telephone Company, Tuolumne Telephone Company, and Winterhaven Telephone Company; John H. Engel, Attorney at Law, and A. J. Smithson, for Citizens Utilities Company of California; Peter A. Casciato, Attorney at Law, for Cellular Resellers Association, Inc.; Randolph W. Deutsch, Attorney at Law, for AT&T Communications of California, Inc.;

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Kenneth K. Okel and Robert N. Herrera, Attorneys at Law, for GTE California, Incorporated; Pierson, Ball & Dodd, by Judith St. Ledger Roty, Attorney at Law, for National Cellular Resellers Association; Kim C. Mahoney, for CP National Corporation; Jeffrey B. Cutherell, for Contel of California, Inc.; Mary Lynn Gauthier, for Gauthier & Hallett; William G. Irving, for County of Los Angeles; Thomas J. O'Rourke, for O'Rourke & Company; and Sidney J. Webb, for himself.

Division of Ratepayer Advocates: Janice Grau, Attorney at Law.

(END OF APPENDIX A)

APPENDIX C

PHASE II COMMENTS

Advantaged Group
Bakersfield Cellular Telephone Company (U-3017-C)
Bay Area Cellular Telephone Company (U-3007-C)
Cellular Dynamics Telephone Company of Los Angeles, Inc.
Cellular Radiotelephone Utilities
Cellular Resellers Association, Inc.
Cellular Service Inc.
Cellular Telecommunications Industry Association
CP National (U-11-C), Citizens Utilities Company of California (U-87-C), Evans Telephone Company (U-1008-C), Kerman Telephone Company (U-1012-C), Pinnacles Telephone Company (U-1013-C), Sierra Telephone Company, Inc. (U-1016-C), The Siskiyou Telephone Company (U-1017-C), Tuolumne Telephone Company (U-1018-C), and The Volcano Telephone Company (U-1019-C)
Division of Ratepayer Advocates
Fresno MSA Limited Partnership (U-3005-C)
GTE California Incorporated (U-1002-C)
GTE Mobilnet of California Limited Partnership (U-3002-C) and GTE Mobilnet of Santa Barbara Limited Partnership (U-3011-C)
International Mobile Machine Corporation
Los Angeles Cellular Telephone Company (U-3009-C)
McCaw Cellular Communications, Inc., Fresno Cellular Telephone Company (U-3014-C), Napa Cellular Telephone Company (U-3016-C), Oxnard Cellular Telephone Company (U-3010-C), Redding Cellular Telephone Partnership (U-3020-C), Sacramento Cellular Telephone Company (U-3013-C), Salinas Cellular Telephone Company (U-3018-C), and Stockton Cellular Telephone Company (U-3012-C)
Pacific Bell (U-1001-C)
PacTel Cellular (U-3001-C) and its affiliates Sacramento Valley Limited Partnership (U-3004-C), Los Angeles SMSA Limited Partnership (U-3003-C), and PacTel Mobile Services (U-4023-C)
Radio Electronic Products Corporation Inc.
San Jose Real Estate Board
Santa Barbara Cellular Systems, Ltd. (U-3015-C)
Santa Cruz Cellular Telephone Company (U-3019-C)
US West Cellular of California, Inc. (U-3008-C)

(END OF APPENDIX C)

APPENDIX B

PHASE I COMMENTS

AT&T Communications of California, Inc. (U-5002-C)
Bakersfield Cellular Telephone Company (U-3017-C)
Bay Area Cellular Telephone Company (U-3007-C)
Cagal Cellular Communications Corporation (U-3021-C)
Cellular Dynamics Telephone Company of Los Angeles, Inc. (U-4046-C)
Cellular Resellers Association, Inc.
Cellular Telecommunications Industry Association
CP National (U-11-C), Citizens Utilities Company of California (U-87-C), Evans Telephone Company (U-1008-C), Happy Valley Telephone Company (U-1010-C), Hornitos Telephone Company (U-1011-C), Kerman Telephone Co. (U-1012-C), Pinnacles Telephone Company (U-1013-C), Sierra Telephone Company, Inc. (U-1016-C), The Siskiyou Telephone Company (U-1017-C), Tuolumne Telephone Company (U-1018-C), The Volcano Telephone Company (U-1019-C), and Winterhaven Telephone Company (U-1021-C)
Division of Ratepayer Advocates
Fresno MSA Limited Partnership (U-3005-C)
GTE California Incorporated (U-1002-C)
GTE Mobilnet of California Limited Partnership (U-3011-C) and GTE Mobilnet of Santa Barbara Limited Partnership (U-3011-C)
International Mobile Machines Corporation
Los Angeles Cellular Telephone Company (U-3009-C)
McCaw Cellular Communications, Inc., Fresno Cellular Telephone Company (U-3014-C), Napa Cellular Telephone Company (U-3016-C), Oxnard Cellular Telephone Company (U-3010-C), Redding Cellular Partnership (U-3020-C), Sacramento Cellular Telephone Company (U-3013-C), Salinas Cellular Telephone Company (U-3018-C), and Stockton Cellular Telephone Company (U-3012-C)
Pacific Bell (U-1001-C)
PacTel Cellular (U-3001-C), and its affiliates Sacramento Valley Limited Partnership (U-3003-C), Los Angeles SMSA Limited Partnership (U-3003-C), and PacTel Mobile Systems (U-4023-C)
Radio Electronics Products Corporation, Inc. (U-2048-C)
Redwood Cellular Communications, Inc. (U-4062-C)
Roseville Telephone Company (U-1015-C)
Santa Barbara Cellular Systems, LTD. (U-3015-C)
Santa Cruz Cellular Telephone Company (U-3019-C)
U S West Cellular of California, Inc. (U-3008-C)

(END OF APPENDIX B)

FREDERICK R. DUDA, Commissioner, dissenting.

Although I agree with the majority's decision to grant downward only pricing flexibility, to reduce tariff change notice requirements, and to make a number of other necessary adjustments to the cellular marketplace, I am filing this dissent because I believe that present cellular rates are excessive and that by allowing these rates to continue into the indefinite future the majority has abdicated its responsibility to enforce the Public Utilities Code § 451 requirement that all utility rates be just and reasonable. I would have preferred a simple mechanism to true-up rates of carriers in the major metropolitan markets to a level commensurate with a fair and reasonable rate of return.

In 1989, CACD analyzed cellular rates of return on investment and found that, by their own calculations, 5 carriers in the 3 major markets earned returns on investment ranging from over 20 to more than 50% percent. The California Reseller's Association analysis of the Los Angeles, San Diego, and San Francisco/San Jose market operations in 1988 show that wholesalers' investment returns in these markets ranged from 25.3 percent to 123.1 percent. CRA's comments showed that the weighted average rate of return on net book plant of the duopoly cellular carriers operating for at least 3 years exceeded 45 percent.

When compared to the returns authorized for other utility sectors, which hover around 10 to 11%, rising to a ceiling level of 16.5% for General Telephone and Pacific Bell, cellular returns in excess of 50% are excessive.

I cannot agree with the majority's rationalization for these excessive rates.

I believe that cellular radiotelephone service is an essential public utility service that is furnished on a non-competitive basis by franchised carriers who, absent some regulatory constraints, have the ability to and in fact do exert

significant market power in the setting of rates. The DRA, in its Phase I Comment, notes: "It appears that market-driven forces rather than the cost of providing service determines the actual prices charged and that there is collusion between the carriers who offer cellular services." Indeed, even in the absence of explicit collusion, the non-competitive character of the cellular market noted by the DRA is entirely consistent with the duopoly market structure adopted by the Federal Communications Commission (FCC) and under which this industry operates. Unfortunately, the majority decision, while generally dismissing the possibility of outright collusion, fails to appreciate the full impact of the FCC-mandated market structure and, as a consequence, has made erroneous findings as to the nature and extent of actual, effective, competition among the wholesale facilities-based carriers.

I will now address the fundamental misunderstandings as to the structure and competitiveness of the cellular market that, in my view, have misdirected the majority to erroneous policy conclusions.

Cellular service is not discretionary for many users. I agree with the County of Los Angeles that the perception of cellular service as discretionary is basic to the majority's proposal for reduced regulation of cellular carriers and is also fundamentally incorrect. For example, the use of cellular communications by agencies of the County of Los Angeles is for essential public safety and other public services the efficiency and effectiveness of which are facilitated by the availability of high quality mobile telephone communications. Cellular telephone service is a natural extension of and enhancement to the wireline telephone network, and is fast becoming no more discretionary to the efficient functioning of a government or business organization than any of a large number of "business telephone services," such as private lines, digital data services, and local and long

distance calling. These facts rebut the majority's discretionary service concept.

In Fiscal Year 1990 the County of Los Angeles will spend some $325,000 on cellular services furnished by PacTel Cellular. Moveover, this expenditure is expected to increase to about $375,000 to $400,000 in FY 1991. Cellular communications is utilized to support and facilitate a variety of public safety and other essential public services, among which are:

- Maintenance of essential contact among Department heads and key management personnel when in transit between county facilities and/or their residences.
- Coordination of various County field services with local municipalities and communities.
- Field use by Department of Children's Services in connection with reported cases of child abuse.
- Coordination of agencies involved in clean-up of hazardous waste spills.
- Hostage negotiation.
- Undercover narcotics investigations.
- Coordination of security and other protocol arrangements incident to visits by various dignitaries.

I am convinced these are highly sensitive important governmental uses of cellular telephone service and are in no way discretionary. I believe it is both unfair and patently incorrect to suggest that cellular is some sort of a "luxury" that deserves less regulatory protection from excessive prices than other essential telecommunications services that, like cellular, are furnished on a monopolistic basis.

Further, cellular service will continue to become more of a basic service into the future <u>if</u> rates are reduced. As rates go down, more business and residential users will enter the market. This will spur the need for more capacity, which (after capital costs are sunk for digitalization) will likely lower the per-unit

costs even further. Thus, rates should decrease even further. As cellular rates decrease, cellular service will become more competitive with landline service, especially if landline rates increase. As we are consistently told by the landline firms, basic landline rates are far below cost. Thus I envision the day soon when the costs and rates for cellular and landline telephony are not far apart. Of course, this is wholly dependent upon affirmative actions by this Commission to reduce cellular rates.

The majority concludes that the duopoly provides for a sufficient level of competition between the two suppliers. They conclude that only through collusive behavior could the two incumbents jointly monopolize the market, and that such behavior would be illegal. However, the duopoly market structure adopted by the FCC is incapable of assuring adequate price competition between the franchised facilities-based carriers. The majority appears to accept the arguments of the facilities-based carriers that the duopoly market structure provides a workably, if not perfectly, competitive market if only minor changes to tariff arrangements are made. I disagree. The duopoly market structure permits the two carriers serving each market to behave duopolistically with respect to their joint pricing policies.

Duopoly theory tells us that both firms will tend to keep prices above the competitive level and compete on service rather than price. Even without explicit collusion, both firms realize that reducing prices will result in lower profits since the other firm can match the reduction; both firms know it is better to limit demand but increase profits by independently avoiding any rate decreases not mandated by regulators. This is exactly what we have seen in California. In D.84-04-014, this Commission set rates in order to provide an adequate return for carriers, as well as a sufficient margin to create a viable business opportunity for potential resellers. Despite customer growth far beyond expectations, which should have reduced the per unit cost of

cellular service, there have been almost no basic service price changes by either carrier in any market since rates were set over five years ago. Instead, cellular returns on investment have skyrocketed.

Wholesale cellular prices should be set on the basis of cost, excluding any economic premiums paid by the facilities based carriers for their acquisition of their cellular franchise on the open market. While cellular radiotelephone systems do in fact exhibit high fixed costs, these are often dwarfed by the substantial market-driven prices that have been paid by their owners to acquire the franchise from a previous holder. These acquisition premiums are not costs in the regulatory sense; they are nothing more than the present discounted value of the monopoly rents that the buyers of these franchises believed were available as a direct consequence of the facilities-based carriers' ability to set prices at monopolistic levels. In other words, these high acquisition costs are based on the assumption that no outside force -- either the market or the regulators -- will prevent the continuation of duopoly profits. The Commission should not permit these discounted excess profits to be transformed into "costs" that are in turn utilized as a basis for setting prices.[1]

History provides a key to understanding the cellular industry today. When the Federal Communications Commission (FCC) in 1979 initiated its efforts to create a regulatory framework for the yet to be established cellular radio service industry, it

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1 The Commission presently excludes acquisition premiums from rate base in order to ensure that utilities earn a return only on plant used to provide utility service and not on unproductive profit motivated acquisition payments. If acquistion premiums were rate based, utilities would have an incentive to increase their rate base through frequent nominal ownership changes and sizable acquisition adjustments; this would exert substantial upward pressure on utility earnings and rates without any accompanying consumer benefits.

confronted the conflicting goals of creating a competitive industry structure while at the same time assuring rapid development and deployment of the new technology to the public. The FCC's response to this dilemma was to allocate half of the available frequency spectrum earmarked for cellular to an indigenous wireline telephone utility while reserving the other half for non-wireline applicants. The FCC thought that although the wireline carrier would be able to initiate service sooner than the non-wireline carrier the non-wireline carrier would eventually provide effective wholesale price competition which could help it overcome the wireline carrier's head start advantage. Unfortunately, the FCC's duopoly market structure creates a bottleneck, allowing suppliers to charge prices well in excess of actual cost.

The scarcity of cellular licenses, coupled with the absence of effective state regulation of cellular rates, made the licenses so valuable that they are now traded at figures many times greater than their original cost.[2]

In other utility sectors, monopoly franchises are granted because we believe that the development of duplicative utility infrastructure would be economically and socially wasteful. Public rights of way would be constantly torn up as redundant pipelines and wires were installed and repaired, and the utilities could not benefit from the full economies of scale associated with their massive investment if their facilities were underutilized because

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2 Wireline carriers in particular have realized an enormous economic windfall from the appreciation in the market value of the wireline cellular licenses which they received at no cost from the FCC. Bacause all of the RBOCs have since transferred these gifted assets to their non-price regulated cellular affiliates, all of the economic benefits associated with the windfall gains and profit opportunities that now exist within the cellular market because of the non-wireline price umbrella accrue in their entirety to stockholders of Pacific Telesis and GTE. There is no cellular cash flow to support basic services.

the demand was too thinly spread over competing systems. Because utility franchises granted for society's benefit could unjustly enrich their owners by giving them monopoly market power, however, the grant of such franchises is accompanied by the placing of limits on the rates those governmentally created monopolists can charge.

Today's decision, unfortunately, gives cellular carriers the opportunity to take advantage of their duopolistic market status with no effective price constraints. We have created an unregulated duopoly.

The magnitude of the monopoly rent, or excess profit, at issue is the discounted present value of future excess profits which is revenues less direct service-related costs, including return on the physical plant actually deployed in providing the service. In my opinion this is the basis for the market values of cellular franchises that have changed hands in California. The excess payment is instead a direct and inescapable consequence of the FCC's duopoly policy and the willingness of regulators such as ourselves to permit cellular carriers to impose prices for their services that include such economic rents. This is a fundamental mistake that must be corrected now.

The monopoly rent that we allow the wholesale carriers to extract from their subscribers is a windfall gain over and above any normal or "fair" return on the investment made in actual cellular plant in service. The earned rate of return on actual investment in cellular plant in service by the Los Angeles wireline cellular carrier, LA SMSA Partnership, was an incredible 41.56% for 1987. The fact that the market value of a cellular utility exceeds the cost of the physical equipment (towers, transmitters, etc.) is further evidence of the presence of a monopoly rent on the cellular capacity. In my view, the presence of these windfall gains is clear evidence of a fundamental failure of regulation of this

service, and one that should be remedied now, before conditions become even more untenable.

I have urged my fellow Commissioners to regulate in a simple and straightforward manner to ensure fair rates for consumers and only reasonable returns to investors. I believe we must do this now. In particular, the regulated wireline telephone utilities who received "wireline set-aside" cellular licenses from the FCC have no more entitlement to benefit from the windfall gains associated with this franchise award in setting service prices than would any other public utility.

Utilities are not entitled to monopoly rents. Economic regulation is intended precisely to prevent utilities from earning such rents. Prices for bottleneck services furnished by franchised, facilities-based cellular wholesale carriers should be set on the basis of cost, defined for this purpose in the same fundamental way as it would be for any other telephone utility under the Commission's administrative jurisdiction. This imperative is the fundamental building block of a growing healthy, stable, universal cellular telephone infrastructure for California. There are alternate ways and means to accomplish this result. I have suggested the simple mechanism of a "true-up" of carrier's rates to a fair rate of return level (perhaps at the high end of that allowed in the Pacific Bell and GTEC sharing formula).

The current high rates cannot be justified by the need to encourage further utility investment. The use of high rates to stimulate investment is contrary to longstanding regulatory law and policy. In the past, telecommunications utility rates were designed to allow a utility to recover the costs of providing the utility service plus a fair return on its rate base investment. Rates of return were set at levels comparable to those earned by businesses facing similar risks; and were designed to maintain the financial integrity of the utility and allow it to continue to attract capital. These returns themselves provide the incentive

for new investment in other utility sectors, which have had no trouble attracting adequate investment capital. None of these basic principles have changed under the new LEC regulatory framework; the added flexibility is intended to increase the LEC's incentive to operate efficiently while still providing service at reasonable rates. There is no reason to create an additional unique windfall incentive for cellular investment by allowing clearly excessive returns now and into the future.[3]

I find complaints about the difficulty of applying rate of return regulation to the cellular industry an unconvincing reason to adopt the pretense of a market based regulatory structure. I also note that my alternate did not advocate traditional rate of return regulation, but merely a simple true-up mechanism similar to that recently adopted in D.89-10-031.

I recognize that, as the majority points out, different carriers have different cost structures. The cost variations may result from the timing of entry into the market place, with variations in the technology utilized, with the acquisition price paid for the cellular franchise, and so on.[4] I note that the impact of these cost differences may be overwhelmed by other factors and that our review of the relationship between the wireline and nonwireline carriers ultimately concluded that neither

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3 Especially since the majority considers cellular service discretionary.

4 Unfortunately, since the wireline licenses were awarded at no cost, while the non-wireline licenses were awarded through a lottery approach that inspired those who were not awarded licenses to bid for licenses from those who originally received them, non-wireline carriers generally paid more for their franchise license than wireline carriers. If all other costs were equal, non-wireline carriers would have to charge more than wireline carriers to recover their investment. Faced with a competitor with an incentive to charge higher rates, the wireline carrier in a market need only charge slightly less in order to compete succesfully. This creates a "price umbrella" for wireline carriers.

had a clear competitive advantage over the other. This conclusion is further supported by evidence that nonwireline carriers often earn a much greater return on their cellular investment than do their wireline competitors.

In any event, I believe that the cellular provider who can provide quality service at the most reasonable price should be allowed to benefit from its economic efficiencies. After all, we are not in the business of offering a safe economic haven for noncompetitive competitors. If we keep rates high simply so the higher-priced provider did not need to take the steps necessary to bring its costs down to a truly competitive level, we are not meeting our obligation to California's cellular consumers. Further, the majority opinion allows downward only pricing flexibility; I support this provision. With this flexibility, the carrier with the higher rates resulting from basing rates more on costs could lower its rates to the levels of the more efficient carrier. This has the additional benefit of giving a strong incentive to the higher cost carrier to become more efficient.

The majority's belief that the current high rates serve the useful purpose of discouraging new demand which might overwhelm the capacity of cellular systems is not supported by the record and leads to an elitist distinction between rich and poor consumers. All parties to this proceeding agreed there were no present constraints on cellular capacity. At worst, there are a few locations in Los Angeles where a temporary bottleneck exists because cell site development lags demand during peak traffic hours. Even if there was a real reason to fear future capacity constraints, a "first come, first served" rationing plan would make more economic and social sense than one which uses price to indirectly regulate demand.

To me, the majority's entire approach seems simplistic and short-sighted. Although it recognizes that current returns on cellular investment greatly exceed those allowed other utilities,

it waxes eloquent about the need to encourage massive investment in this allegedly discretionary utility service and refuses to reduce rates to reasonable levels. Consumers are supposed to take comfort from statements that sometime down the road, if we believe rates have not been reduced to levels necessary to provide full utilization of the cellular system, we will review rates and reduce them if necessary. Under a capacity utilization approach, however, it would seem probable that all cellular carriers would need to do to meet the majority's full utilization criteria would be to offer a series of small rate reductions designed to ferret out the highest level of prices the market would bear and still keep the system full. These rates could still be far in excess of those needed to recover operational costs and a fair return, but they would almost certainly lead the majority to conclude that the rates were still just and reasonable unless, of course, the majority eventually decides that rates should bear some relationship to the costs incurred in providing the utility service.

Even if effective competition is not present at the wholesale level, there is at least the possibility that it might occur at the retail level if the facilities-bases carriers are required to allocate costs between these two activities in a fair and reasonable manner and to set their wholesale prices on the bases of the appropriately allocated costs of wholesale service. This is one of the encouraging signs in the majority opinion. However, this is unlikely to occur absent an explicit regulatory requirement, because the facilities-based carriers have a strong economic incentive to frustrate competition at the retail level as well as the market power to accomplish precisely this result. The majority's approach may help to control this problem; we shall see.

In any event, requiring retail operations to be profitable will not solve the excessive wholesale rate problem.

In my view wholesale and retail cellular prices are excessive and must be reduced. Excessive pricing of this essential

telecommunications service discourages beneficial usage and creates deadweight losses in the economy generally. I believe the appropriate regulatory action that will prevent franchised facilities-based wholesale cellular carriers to extract monopoly rents from their control of scarce bottleneck cellular licenses is for wholesale cellular rates to be set on the basis of cost.

Although this is a relatively new industry, it is clearly operating well beyond any "start-up" phase in which the capital costs are so high that current cash flows are necessarily negative. A $500 million a year, 5 years old industry is not a start up operation. The fact that the market for cellular licenses will support prices that are many multiples of the actual cost of cellular plant is, standing alone, a fully sufficient demonstration that no special regulatory considerations with respect to start-up or capital attraction is required. Experience shows capital investment has been no problem. The only reasonable conclusion that is possible is that cost-based prices developed in a manner that is consistent with traditional Commission practice are essential to assure that this important and essential service is offered on a fair, just, reasonable and non-discriminatory basis. My alternate proposed to regulate profits so as to achieve that positive result.

The opinions I have expressed here have adopted to a great extent material submitted in this case by the County of Los Angeles. Their comments brought clarity, insight and perception to the issues. In particular, I concur with the L.A. County analysis of the cellular industry origins, growth, and development leading to the opportunities and problems of today. I deeply regret that rate reductions that the people of California are entitled to are not being ordered at this time.

The people of the State of California as U.S. citizens are the owners of the cellular airways, the radio spectrum. It is for their benefit that licenses to use that radio spectrum are

given. Spectrum use must never be managed in any way that deprives the people of what is rightfully theirs. Cellular utilities should be required to expand their facilities and use the most modern technology in order to make this incomparable service available to the greatest number of Californians possible.

It is this Commission's fundamental duty to make sure Californians receive the best service at the least cost. This duty is owed to all Californians, not just the wealthy ones. Excessive rates for cellular service deprive many people the use of this valuable service. Many small businesses suffer competitive disadvantages because they can't afford cellular prices at current rates. This is wrong and must be corrected. The denial of rate reductions leaves unjust rates.

Potential future rate reductions are but pie in the sky. I believe that justice delayed is justice denied. The present failure to order the adjustment of rates downward to a just and reasonable level is a grave mistake. This glaring error can be corrected; the sooner the better.

/s/ FREDERICK R. DUDA
Frederick R. Duda, Commissioner

June 6, 1990
San Francisco, California